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THE PRESIDENT'S EXPORT COUNCIL

SUBCOMMITTEE ON EXPORT EXPANSION

DECEMBER 5, 1979

REPORT OF THE TASK FORCE TO STUDY THE TAX TREATMENT OF AMERICANS WORKING OVERSEAS

THE PRESIDENT'S EXPORT COUNCIL
WASHINGTON, D.C. 20230

December 10, 1979

The President
The White House
Washington, D. C.

Dear Mr. President:

The Executive Committee of the President's Export Council has asked me to express to you its strong concern over the adverse effects on exports of the present rules (Sections 911 and 913) concerning taxation of foreign earned income of Americans living overseas.

The Foreign Earned Income Act of 1978 has done little to alleviate the problems of differences in tax treatment between American citizens working overseas and their counterparts from competing industrial nations. The result has been that third-country nationals, who generally do not have the burden of paying taxes in their home countries on their foreign earned income, are employed instead of American citizens. This has brought about a sharp loss in the U. S. share of overseas business volume in vital economic sectors, largely because third party nationals tend to specify equipment manufactured in their home country, whereas American citizens would specify and order U. S. equipment with which they are most familiar.

A particularly disturbing example is the decline in the position of American contractors on projects in the Mid-East. According to McGraw-Hill, U. S. companies had contracted for $8.9 billion or 10.3% of the total contracts let in the Mid-East from June 1975 through April 1978. During the 13 months ending in June 1979, U. S. contractors received only $346 million or 1.6% of the total contracts awarded. The loss of U. S. jobs both overseas and at home to foreign competitors, and the accompanying loss of U. S. exports, comes at a time when it is crucial to maintain U. S. prestige and presence overseas and a firm emphasis on increasing our share of the world market.

The President's Export Council appointed a task force to study this problem. The following administrative recommendations, aimed at putting Americans who work in the private sector overseas on a more comparable tax footing with citizens of competing industrial nations, are adapted from this report.

- Regulations and interpretations in force under the current tax law concerning Americans living in camps in hardship areas (Section 911) should be simplified and made less restrictive, in keeping with the intent of Congress.

- The current tax law concerning allowances to employees for excess living costs incurred while working abroad (Section 913) should be interpreted in the least restrictive and simplest manner.

We have discussed these recommendations with Secretary Miller and would appreciate your endorsement of them.

The final task force recommendation is that work begin immediately to encourage enactment of new tax provisions directed to this problem. We have called upon a broad spectrum of the American export sector for comments on specific legislative points which would relieve the burden under which they now operate, and would be in the national interest.

I am sure it was not the Administration's intent, or that of Congress, to discourage the employment of Americans by U. S. business overseas. The tax law must be one that enables Americans to face the uncertainties of life abroad and serve as the leading edge of the export growth that is necessary if we are to maintain the leading economic role for the U. S. in today's world that is so essential to our welfare.

Respectfully yours,

Reginald H. Jones

Reginald H. Jones
Chairman

THE PRESIDENT'S EXPORT COUNCIL
SUBCOMMITTEE ON EXPORT EXPANSION

Task Force to Study the Tax Treatment of Americans Working Overseas

I. THE SITUATION

Despite the enactment of the Foreign Earned Income Act of 1978, Americans are still being taxed out of competition in overseas markets. The result is a sharp loss in the United States' share of overseas business volume in vital economic sectors. The current situation contributes to our negative balance of payments, a loss of U.S. jobs to our competitors, and the decline in U.S. presence and prestige abroad.

II. TASK FORCE RECOMMENDATIONS

Americans working overseas are essential to a viable export program. An increase in the number of Americans assigned abroad can increase our exports, reduce the negative balance of payments, enhance our country's image, and raise employment in the U.S.

Recognizing that it is in the best interest of our nation to encourage Americans to work overseas, the Task Force recommends the adoption of tax policies that are comparable to those of major competing industrial nations, none of which now tax citizens who meet overseas residency tests. We urge the development and enactment of new legislation to put Americans who work in the private sector overseas on the same tax footing as citizens of competing industrial nations. In the interim, the following remedial actions should be taken:

1. Regulations and interpretations in force under the current tax law concerning Americans living in camps in hardship areas (Section 911) should be simplified and made less restrictive, in keeping with the intent of Congress.

2. The current tax law concerning allowances to employees for excess living costs incurred while working abroad (Section 913) should be interpreted in the least restrictive and simplest manner.

3. Work should begin immediately to encourage enactment of a new tax law to put Americans working overseas on the same tax footing as citizens from competing industrial nations.

III. BACKGROUND

Foreign Trade Encouraged

Beginning in the 1920's, after the U.S. emerged from World War I as a major exporting nation, the income earned by Americans at work in foreign countries was virtually exempt or excluded from U.S. taxes, as a matter of public policy and by specific acts of Congress. The purpose was to encourage foreign trade. It was recognized that the export of U.S. goods and services dependent, in large measure, on the presence of Americans in overseas markets.

The U.S. tax policy was not unique. All of our trading partners, and certainly all of the world's major producing nations, had long excluded income earned by citizens at work overseas from taxation.

In the early 1950's some revisions were made in the tax treatment of U.S. citizens working overseas. The principal aim was to halt abuses by highly paid movie stars. These revisions altered foreign residency tests and placed a ceiling on the amount of foreign-earned income that could be excluded. The income and allowances of most Americans working overseas was below the $20,000 limit, so they were not affected. They were not meant to be.

Additional technical adjustments were made during the 1960's in foreign residency tests and in the sums that could be excluded. By the mid-1970's, the effects of inflation — rising living costs and rising salaries and benefits for overseas American workers — had overtaken the amount of foreign-earned income that could be excluded from U.S. taxes.

Policy Shifts in 1976

Responding to misguided arguments that Americans overseas were being granted preferential tax treatment, Congress in 1976 reduced the exclusion to $15,000 and changed the manner in which it was computed so its maximum practical effect became about $3,000. The philosophy behind these provisions was directly contrary to the principles which had guided the United States' tax treatment of overseas Americans for more than 50 years. Instead of encouraging Americans to work overseas, the 1976 amendments actually discouraged such employment. In fact, even before the 1976 amendments, it was becoming less attractive to work overseas. Inflation was running at between 50 percent and 300 percent higher than domestic inflation, a fact that should have been recognized by increasing the $20,000 exclusion rather than decreasing it.

Further, the Tax Court ruled in 1976 that employer furnished housing was taxable to employees at full local rental value, rather than the value of similar housing in the United States. These rulings were interpreted as a strong indication that employer contributions to offset extraordinary overseas living expenses — or so-called "keep whole" contributions — were taxable to overseas employees, whereas such amounts often may have gone unreported up to that time.

These rulings, when combined with the 1976 tax code revisions, produced effects that Congress and the Tax Court did not foresee. For example, in the oil-rich Middle East, the costs to an employer of maintaining an American worker at something approximating the standard of living he or she would have enjoyed at home could exceed the actual salary paid to that worker by three or four times. As a result, some Americans overseas became liable for more taxes than they received in real income.

The 1976 tax policy shifts on foreign-earned income actually amounted to a substantial tariff on our own goods and services by our own government.

Foreign Earned Income Act of 1978

After belatedly postponing the effective date of the tax code revisions, Congress moved in 1978 to remedy the devastating mistakes of 1976 with the Foreign Earned Income Act. Unfortunately, the 1978 Act is inadequate. The House of Representatives had passed a realistic bill, but the law that was eventually enacted represents a compromise with a more restrictive Senate version. Section 911 of the Act provides a $20,000 exclusion for overseas Americans living in qualified camps in remote hardship areas. Section 913 provides deductions for certain allowances for extraordinary overseas living expenses under fairly strict qualifications. Both Sections 911 and 913 are very complex. Moreover, regulations drafted by the Internal Revenue Service under the new law effectively reverse the intent of Congress by compounding the complexities beyond reason.

Even if the Foreign Earned Income Act of 1978 is interpreted in the least restrictive way possible, it is clear that overseas Americans are not currently competitive with citizens of other nations in terms of taxes.

IV. RATIONALE FOR RECOMMENDATIONS

Americans at work overseas direct business to our domestic economy. If we are to increase exports in order to bring our trade accounts into balance, we must encourage more U.S. citizens to accept assignments with American business overseas. Concurrently, we must continue to be sensitive to the geo-political ramifications of having more Americans working abroad. Overseas employees of American business are seen as representatives of our country. Through their participation and visibility in international business affairs, they can function as goodwill ambassadors whose work exemplifies America's ideals and values.

To achieve these benefits will require, among other things, that current tax laws bearing on foreign-earned income be changed. At present, our nation's tax policies discourage the employment of Americans overseas. Many American companies doing business overseas, especially in the manpower-intensive service industries, are sending American employees home in order to keep some vestige of market share. For example:

- Recruiting firms in France, Germany, Italy and the United Kingdom report they are swamped with requests for qualified citizens of their respective countries to replace Americans who are being forced home by U.S. tax policies.
- Several leading U.S. contractors in the Middle East have reduced their American staffs by more than half, and adopted hiring policies overseas that specifically exclude Americans on future work.
- The University of Petroleum and Minerals in Saudi Arabia says Americans now make up less than 30 percent of its teaching staff, compared to more than 80 percent several years ago.

Replacing American employees with citizens of other countries is the only way American companies can remain competitive. This means that as U.S. companies operating overseas "de-Americanize," sales of goods and services move away from this country and toward the competing industrial nations.

- A report by the Government Accounting Office suggested that the impact of current U.S. tax policies for overseas Americans might be very significant — with a reduction of 5% or more of total exports or a loss in overseas sales of at least $6 to $7 billion, based on available data. And the GAO report cautioned that its projections might well prove conservative.[1]

[1] Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas. Report to the Congress. Comptroller General. February 21, 1978, page 10.

- The Commercial Counselor of the Embassy of Saudi Arabia recently observed:

> "U.S. tax treatment of American companies doing business in foreign countries makes them less competitive *vis a vis* European and Japanese (and other) companies, which receive better tax treatment from their governments. In the case of Saudi Arabia, it is noticed that American companies, in order to overcome the higher costs resulting from the unfavorable tax treatment, have tended to hire non-American engineers and other skilled personnel. Naturally, these prefer equipment and specifications originating in their countries (European or Japanese, etc.), which represent a loss in American exports to Saudi Arabia. Thus, the end result of U.S. tax treatment of American personnel working abroad has been a net loss of American sales abroad."

That means a loss of jobs in our economy. Estimates vary. Using the low end of the Department of Commerce estimate that for every $1 billion in new economic activity between 40,000 and 70,000 jobs are created, a loss of 5% of our current overseas export volume — or about $7 billion in economic activity — would produce a job loss of 280,000. Using the same Department of Commerce figures, if the U.S. decided on policies to increase exports by at least $30 billion annually as a means of bringing the trade accounts into balance, at least 1.2 million new jobs would result.

If we increase our nation's exports we will increase job opportunities for Americans at home and abroad. In order to achieve such improvement, we must re-assess our tax policies. We also must write new tax laws directed at placing Americans on a competitive footing with other nationals in overseas markets. (See Chart Below)

V. CONCLUSION

The principle underlying the taxation of Americans working in other countries should be to encourage, rather than discourage, employment with U.S. business overseas. The implementation of this principle through changes to the Internal Revenue Code will increase the number of U.S. citizens who are willing to work overseas, resulting in an increase in American exports.

Respectfully submitted,

Robert Dickey III
John Wood Brooks
D.L. Commons
Maurice Sonnenberg

December 5, 1979

Comparison of Tax Policies for Overseas Employees

Country	Tax on Salary	Tax on Incentives/ Bonuses	Tax on Benefits (Retirement, Health, Insurance, Etc.)	Tax on Cost of Living Allowances	Tax on Additional Income Earned Out of Home Country	Notes:	Government Subsidies (To Individual)
United States	Yes[1]	Yes	Yes	Yes[2]	Yes	[1]20,000 exclusion under Section 911 for those in qualified camps. [2]Certain deductions permitted under complex Section 913 tests.	No
Japan	No	No	No	No	No[1]	[1]Rental, interest, etc. on off-shore investments totally exempt from taxation during non-residence status **only**.	Yes
Italy	No[1]	No	No	No[2]	Complex formulas to discourage foreign investments	[1]Complex non-residency requirements. [2]Limitation placed on daily expenses for home leave and R&R.	Government owned companies
France	No[1,2]	No	No	No	Complex formulas	[1]Assumes accompanied tour/rules for dual residency—unaccompanied—very complex. [2]Recent government policy aimed to encourage more French engineers to accept overseas work.	Government owned companies
Korea	No	No	No	No	No	[1]Most liberal policies with respect to individuals — Korea committed to exports of domestic unemployment.	Yes
Germany	No[1]	No[2]	No	No[3]	Some limitations. Generally liberal.	[1]Complex non-residency requirements aimed at tours of less than 6 months. [2]Complex definitions. [3]Some limitations designed to reduce excesses.	Few
Canada	No[1]	No	No	No	No	[1]Accompanied tour only. If family of head of household remains in Canada **all** worldwide earnings subject to full taxation.	No
Sweden	No	No	No	No	No	[1]Recently liberalized tax policies in order to encourage acceptance of overseas assignments.	Few
United Kingdom	No	No[1]	No[2]	No	Complex requirements	[1]U.K. recently liberalized tax policies in order to encourage. [2]Some limitations.	Few

Compiled from data provided in Worldwide Projects and Business International S.A./Consultex S.A., a multiclient study, The Expatriate Employee, 1979.

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ABGR

مجموعة رجال الاعمال الامريكيين في الرياض

POSITION PAPER

AMERICA'S LOSS OF BUSINESS IN THE MIDDLE EAST

U.S. COMPANIES OPERATING IN THE MIDDLE EAST ARE AT A COMPETITIVE DISADVANTAGE WITH EUROPEAN AND ASIAN FIRMS BECAUSE OF U.S. LEGISLATION AND EXECUTIVE ACTION WHICH RESTRICTS AND IS OFTEN PUNITIVE AS COMPARED TO GOVERNMENTAL SUPPORT BY OTHER NATIONS FOR THEIR COMPANIES OVERSEAS

We call on the United States Congress to recognize this situation and to enact immediate legislation which would --

√ • *eliminate taxes on American expatriates which force U.S. firms to hire foreigners or price themselves out of the market;*

• *provide financing for American firms which would put them on a competitive footing with foreign firms; and*

• *rationalize anti-trust, anti-boycott, anti-corruption and other laws which penalize U.S. firms abroad without advancing any significant policy objectives.*

The Kingdom of Saudi Arabia is in the world's largest single market for construction and other contracted services, for the related consulting and design fields, and for the attendant materials and equipment. As such it is also the most competitive single market for these labor and production intensive services in the world. It is likely to remain so for at least the decade of the 80's. [1]

U.S. firms are losing ground rapidly in Saudi Arabia. While fully 9% of all construction projects in the Kingdom were awarded to U.S. contractors in 1975, our share dropped to 6% in 1978 and continues to decline with only 3% of construction going to U.S. firms in 1979.

Even the civil and military construction contracts let by the U.S. Army Corps of Engineers on behalf of the Saudis are going substantially to foreign firms. In fact, the U.S. share of such work has plummetted dramatically from 35% in 1975, to 5% in 1978 and then to 2% in 1979.[2]

As a result, the total U.S. exports to Saudi Arabia show no real dollar growth, 1979's $4.9 billion being, in fact, a decline from 1978's $4.4 billion when adjusted for a 12% inflation rate. Moreover, the U.S. portion of the Kingdom's enormous import bill, averaging 22% over the period 1975 - 79 is beginning to show a noticeable decline. [3]

The health of this market affects all Americans, because U.S. firms buy American products. According to the Associated General Contractors of America, 90% of the material and equipment used by U.S. contractors are U.S. products. [4] The U.S. Department of Labor estimates that every billion dollars in exports generates 30,000 *domestic* jobs. The U.S. Commerce Department puts the figure at 40,000 jobs per billion dollars of exports, and a study conducted by Aramco shows 53,000 U.S. jobs created by the same one billion dollars. Thus, the Saudi Arabian market is responsible for between 145 and 260 thousand domestic U.S. jobs. [5]

U.S. firms are not losing ground in Saudi Arabia due to attitudinal hindrances on the part of either ourselves or our hosts, as some assert. The Saudis still desire American goods and services; they are simply no longer willing to pay the ever growing premiums for buying American over European or Asian. Certainly the very existence of our group attests that U.S. firms are interested in this market; sufficiently interested to dedicate their full efforts and resources to working here in the Kingdom.

The fact is that we can no longer successfully compete with foreign firms who receive support from their respective governments. This support ranges from effective subsidies to outright ownership, control and supply of labor. The policies of most foreign governments with respect to assistance to their own firms in foreign markets renders U.S. legislation highly disincentive by comparison. If the U.S. wishes to reverse the current trend, to regain lost foreign sales and the resultant income and tax revenues, to improve our enormous trade deficits, and to return to a leading position in the world marketplace, U.S. firms operating overseas must be allowed to confront foreign competitors on a more equal footing.

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INDIVIDUAL TAX

The single item most often cited by U.S. firms operating overseas and by independent investigators as a cause for the dwindling U.S. share of international business is the current text and interpretation of the individual foreign earned income legislation, Sections 911 and and 913 of the Internal Revenue Code. [6] No other industrial nation taxes the overseas earning of its citizens as rigorously and no other major industrial power taxes such earnings at all. It is more than coincidence that it is just these same powers -- South Korea, West Germany, the U.K., Japan, Italy, Canada and France -- to whom U.S. firms are losing work at present. [7]

The direct effects of the present legislation are two-fold. First, bids tendered by U.S. firms are inflated by the projected excess cost of maintaining taxed American personnel and are thus unsuccessful. A study made by the Associated General Contractors of America of an actual bid shows that the projected cost of using American staff was nearly twice that of using comparable British staff. 75% of that difference was found to be the result of taxing the American individuals' foreign earned income. This resulted in a total bid 3% higher for the American-staffed U.S. firm. A 2.3% spread in offers prevailed at the time and the U.S. firm did not receive the work. [8] Zero work means zero income for the U.S. economy and zero tax revenues.

Second, these taxes are forcing U.S. firms to replace American staff with British, Irish and other English speaking expatriates who are not taxed on income earned abroad. Mr. Abdullah T. Dabbagh, Commercial Counselor at the Embassy of Saudi Arabia in Washington states that the proportion of U.S. citizens employed by U.S. firms in the Kingdom declined from 65% in 1976 to 35% in 1980 due to the 1976 tax law. The findings of the Middle East Marketing Research Bureau Ltd. investigating U.S. firms in Riyadh, showed a 10% drop in U.S. citizen employees of U.S. firms over the period 1977 - 78 with heavier losses in the numerous mid-sized firms. This corroborates a report by Chase Econometrics Associates, which estimates a further 10% drop for 1980. [9]

Beyond the obvious loss of income and revenues attendant to declines in the hiring of U.S. citizens to work abroad, there is also the fact that people tend to direct business to their countries of origin due to familiarity with home specifications and products as well as to a modicum of nationalism. In Saudi Arabia, where nearly everything is imported, this phenomenon is most pronounced. Over the past five years, the character of importing to the Kingdom has changed drastically. While at one time, items were usually imported for a specific project, local dealers and vendors now pre-import vast quantities of materials and equipment for sale on the local market. Our collective experience has shown us that, given this ever increasing local availability, people will procure the products of their countries of origin whenever possible. A very telling example of this is the fact that export of U.S. heavy equipment to Saudi Arabia fell 5.5% from $200 million in 1978 to $189 million in 1979. [10] Further, our experience shows conclusively that the days when only U.S. products could meet U.S. firms needs and U.S. or U.S. based specifications are sadly, over. Both Japan and Korea produce many items to American standards, and much of Europe produces substitutes acceptable even to the Corps of Engineers.

Perhaps the most remarkable fact about taxing U.S. citizens' foreign earned income is the number and variety of entities and interests that agree such taxation is highly detrimental to U.S. exports and should be reduced or eliminated. Most recently, **THE CHASE ECONOMETRICS ASSOCIATES STUDY CONCLUDED THAT PRESENT TAX POLICY ON INDIVIDUAL FOREIGN EARNED INCOME WILL RESULT IN A 5% DROP IN EXPORTS, WITH A RESULTANT FEDERAL TAX REVENUE LOSS OF SOME $6 BILLION, AND ADD 80,000 PERSONS TO OUR DOMESTIC UNEMPLOYMENT LINES.** [11] The President's Export Council has recommended that a substantial portion of foreign earned income be excluded from taxation. [12] Senators Jepsen (R-LA), Chaffee (R-RI) and Bentsen (D-TX) as well as Representatives Frenzel (R-MN), Jones (D-OK) and Neal(D-NC) all have drafted reform legislation which reduces such tax liability significantly. Both the mass media and the trade press have expounded on the adverse effects of the current law. [13] Even Saudi Arabian business and government leaders cite the tax law when explaining the declining American presence and success in the Kingdom. [14] Finally, every one of the many U.S. Government officials who have visited and addressed the American Businessmen's Group of Riyadh, including Treasury Secretary Miller, have indicated support for our position.

That legislators from both houses of Congress, from both major parties and from all geographical sectors are in agreement with the findings of independent researchers, the press, various citizens committees, the business community and the President's Council should be overwhelming. There is apparently but one major dissident group - the U.S. Treasury and its Internal Revenue Service, who persist in the delusion that the United States economy will lose if the law is changed. We call upon the Congress and upon the Administration to carefully re-examine the full body of facts, whereupon we are confident they too will perceive the need for immediate and effective reform of this unfair and senseless legislation.

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FACTS AND FIGURES

DOMESTIC U.S. JOBS PER $1 BILLION EXPORTS

NO. JOBS	SOURCE
30,000	U.S. Department of Labor
40,000	U.S. Department of Commerce
53,000	Arab American Oil Company

Source: SAUDI REPORT, 12 Nov. 1979

TOTAL U.S. FOREIGN CONTRACTS WORLDWIDE

1975	$ 21.3 billion
1976	$ 15.6 billion
1977	$ 15.9 billion
1978	$ 18.3 billion

Source: ENGINEERING NEWS-RECORD, 19 Dec. 1979

PRODUCTIVITY RISE

1968 to 1978	Netherlands	93.7%
	Japan	89.1%
	France	60.8%
	United States	23.6%
	United Kingdom	21.6%

Source: U.S. BUREAU OF LABOR STATISTICS

U.S. CITIZEN PORTION OF U.S. FIRMS' EMPLOYEES IN KINGDOM

1975	67%
1979	33%

Source: U.S./ARAB COMMERCE, Apr. May 1980

TOTAL U.S. EXPORTS TO SAUDI ARABIA

1978	$ 4.4 billion
1979	$ 4.9 billion

Source: U.S./ARAB COMMERCE, Apr. May 1980

U.S. SHARE OF WORLD EXPORTS

1957	21%
1979	12%

Source: ARAB NEWS, 18 June 1980

U.S. SHARE OF TOTAL SAUDI IMPORTS

1975 80	22% cumulative
1975	23%
1978	21%

Source: U.S./ARAB COMMERCE, Apr. May 1980

CONSTRUCTION CONTRACTS WON BY U.S. FIRMS

	In Kingdom	U.S. Army COE
1975	9%	35%
1978	6%	5%
1979	3%	2%

Source: SAUDI REPORT, 12 Nov. 1979

U.S. CONSTRUCTION EQUIPMENT SALES IN SAUDI ARABIA

1978	$ 200 million
1979	$ 189 million

Source: INTERNATIONAL CONSTRUCTION WEEK, 30 June 1980

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unusual departures from the standard operating mode at foreign policy think tanks. Perhaps the most dramatic — and successful — was CSIS's bold jump into the energy field. Long before the days of gasoline lines and annual OPEC price hikes, the Center took on a specialist from the Congressional Joint Atomic Energy Committee, Jack Bridges, to help it inform the nation of the coming oil shortage and its implications.

Abshire recalls with a wry smile that many of his colleagues were skeptical at the time: "People said to us, 'Why would a strategic center get into energy? That's not strategic.' These precise words were used with me."

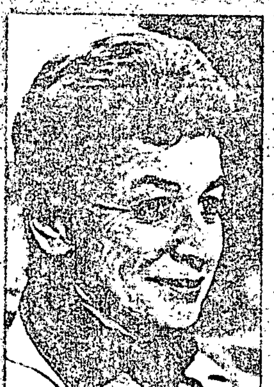
But the Center staff was impressed with a three-dimensional display unit Bridges had devised showing the future of American oil supplies, matched with probable rates of consumption, through the end of the century. The picture was graphically urgent. Yet when Bridges briefed interested congressmen and bureaucrats, few fully grasped the significance of his data. Then the embargo came, and his audiences increased.

Under Center auspices, Bridges gave detailed briefings on energy to eighty senators, half of the House of Representatives, several state legislatures, and numerous corporate boards — in all, an estimated thirty-five thousand people. And for those who could not understand the Bridges statistical model, CSIS worked with Hollywood's Hanna-Barbera Productions to conceive and produce a Flintstone cartoon film narrated by Charleton Heston. The film and related television spots have taken the energy

The Export War—Why We Are Losing It

Last year, the U.S. balance of trade deficit — the gap between what we bought as imports and sold as exports — approached the $30-billion mark, a figure that not only dwarfs the gross national products of many other nations, but also provides vivid illustration of what economists tell us is a serious, long-term decline in the American share of world export markets. From commanding more than a quarter of all foreign markets in 1948, the U.S. trade position had fallen, by 1978, to a 14 percent share of all markets. And the outlook for the future remains bleak — despite five separate export-expansion policies in the past 15 years.

Why have exports proven so resistant to the government cure? Michael Samuels, CSIS executive director for Third World Studies and head of the Center's Export Competitiveness Project, argues that Washington's medicine has not yet been strong enough. He disagrees with those who think that the U.S. export position can be improved simply by adjusting monetary policies and other pricing mechanisms. The problem runs deeper than price competitiveness alone, he says, and involves complex world economic trends that the U.S. government has yet to deal with adequately in a long-term program of export stimulation.



Penelope Hartland-Thunberg,
Director of Economic Research

Samuels' colleague in the CSIS export study, Senior Research Economist Penelope Hartland-Thunberg, examines the historical roots of the decline in her paper, "The Political and Strategic Importance of Exports," the first of 20 research publications slated for the project.

"It used to be said in the early 1950s that when the U.S. economy sneezed, Europe got pneumonia," Hartland-Thunberg writes. No longer, however, is America's economic might so pervasively awesome to the rest of the world. In fact, she says, the increasing vulnerability of the U.S. economy itself to external events reduces the potency of economic influence as a weapon in America's arsenal of national power. Hartland-Thunberg traces this vulnerability directly to the decline in U.S. exports relative to imports. And the decline, she says, is due to the survival of a "Marshall Plan mentality" long beyond its period of usefulness.

After World War II, explains the researcher, the United States deliberately adopted policies that would result in a balance of payments deficit, over-valuation of the dollar, and the primacy of imports over exports. The purpose: to foster economic recovery in Europe and the Pacific. "It was an article of faith," she says, "that peace depended on political stability within and between countries, and that political stability depended on economic growth." The United States, holding a whopping 50 percent of the international currency reserves by the war's end, was so economically superior that a de-emphasis on exports seemed not only harmless but mandatory to restore a balance of economic power and health to the world.

The problem, says Hartland-Thunberg, came when our helping-hand economic policies remained in place long after they had fulfilled their original purpose. For many reasons — not the least of which were the need to bolster allies against communist in-roads and a lack of sufficient alertness in the government — the American de-emphasis on exports became institutionalized. And while such new competitors from the developing world as South Korea and Taiwan were prospering with our aid, and the economies of old foes Japan and West Germany were soaring (even in the fifth grade in Japan, notes Hartland-Thunberg, textbooks stress the importance of exports to national welfare), the U.S. economy was recording these distressing trends:

"The balance of payments deficit, which had been averaging $1.5 billion during the 1950s, rose to over $3 billion for most of the 1960s and then mushroomed to $22 billion in 1971. U.S. exports, which amounted to one-quarter of the world total in 1948, had declined to 17 percent by 1958 and to 14 percent by 1970. Between 1950 and 1970, world production expanded 4-1/2 times, U.S. production by less than 3-1/2 times; world trade expanded fivefold over the same period, U.S. trade by less than 4-1/2 times. U.S. gold reserves, which in 1948 had been more than three times the level of dollar claims of foreigners against the United message to more than a hundred million Americans.

CSIS maintains its emphasis on energy with a barrage of research papers, frequent special conferences, and regular seminars for Federal staff. More than a third of all CSIS projects, in fact, fall within its section devoted to resources studies, headed by Dr. Amos A. Jordan, a former Rhodes Scholar and Army general who was also a deputy assistant secretary of defense and deputy undersecretary of state. In addition to oil, the resources group studies such issues as shortages in strategic minerals, worldwide food distribution, population pressures, and economic conditions. But the single largest outlay of funds at CSIS (more than $1 million) has gone to an energy project: the highly praised effort to bring together the nation's industrial leaders and environmentalists to pave the way for an agreed-upon coal policy.

Energy may represent the first area in which the link between domestic policy and foreign policy has become obvious to the public. But CSIS's insistence on viewing problems from several angles at once is helping to bring other such links to light.

One of the Center's largest current projects, for example, involves the first major study (more than twenty publications) of the nation's steady decline in export competitiveness, especially in the developing world. Already, Center experts claim, the export situation has emerged as a parallel to America's decline in global power and energy sufficiency.

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States, by 1971 had declined to 10-15 percent of those claims."

Efforts since 1971 to bolster exports and support the American economy abroad have not been successful, Hartland-Thunberg says, because "old habits die hard." The various occupants of the White House and their aides have continued to encroach on U.S. export performance, she says, through "creeping incrementalism — successive laws, regulations, and initiatives, not one of which has great export significance in isolation," but which cumulatively add export restraints to counter new export-expansion policies.

Complicating the export picture in the coming decades, adds Samuels, are two major trends in world trade that Washington will have to address decisively. The first is the rise of a strong new "middle class" of nations from the Third World. Multinational corporations in South Korea, Taiwan, the Philippines, Hong Kong, Brazil, India, Singapore, Mexico, and many other parts of the pro-West or non-aligned world, says Samuels, are providing increasingly stiff competition for U.S.-based multinationals. And in the 1980s and 90s, America will be forced to find ways to balance its desire for economic security in these strategic areas with the growing need to shore up its own deteriorating economic status in the world. The national security implications of our economic slide, he warns, are every bit as grave as a military decline. Says Samuels: "Traditional military considerations can no longer stand alone or even predominate in a 'national security' assessment. In fact, our military allies may become our economic adversaries."

Adding to this dilemma is the threat posed by a proliferation of state-owned companies abroad — not only in the non-aligned Third World, but also in Western Europe, particularly in Scandanavia. The growth in government ownership of foreign industry is "changing the rules of the game in international competition," says Samuels. Such highly subsidized companies need not seek profits comparable to their privately owned competitors, nor will their losses lead to bankruptcy. In addition, they are provided ready investment capital for improvements and diversifications and are encouraged to purchase domestic raw materials — a factor further affecting world trade competition.

How strong is the trend toward government-owned competition? Samuels offers these figures and projections to show the scope of the problem:

- By the mid-1980s, companies owned or controlled by government are expected to account for nearly 50 percent of the U.S. chemical industry's competition in export markets for petrochemicals, fertilizers, and plastics.
- About 55 percent of the noncommunist world steel production is already owned outright by government.
- State ownership is already evident in telecommunications, electricity, gas, oil production, aluminum, coal, paper, railroads, airlines, textiles, motor industries, electrical and non-electrical equipment, and shipbuilding.
- The state has an ownership stake in 19 of Europe's 50 largest industrial companies.
- Investment in government-owned enterprises accounts for more than 25 percent of all investment in Sweden, 50 percent in Austria, and 35 percent in Italy.

Samuels' answer to the export problem includes the modification of current U.S. restrictions on foreign trade. In a recommendation that may come as strong medicine to some segments of the population, he urges that "tax laws, environmental regulations, antitrust obstacles, and foreign corrupt practices laws be revised with an eye toward making the interests that initiated them subordinate to the national need to expand exports."

First, however, he recommends a broader public discussion of the causes and consequences of America's economic decline abroad, and greater government effort to assess the impact of competition from state-owned companies. We need an "export offensive," says Samuels, and the American people should demand that this year's presidential candidates "make clear their support for an export stimulation policy."

Adds Hartland-Thunberg, "Recovery of U.S. stature in the world scene is dependent on a vibrant export performance."

NEW RULES TAXING AMERICANS WORKING ABROAD*

BY

CHARLES M. BRUCE**
Counsel
Senate Finance Committee

While unwilling to abandon the concept of worldwide taxation of U.S. citizens wherever they reside, Congress reversed the decisions which it made in the Tax Reform Act of 1976 and provided in the recently enacted Foreign Earned Income Act of 1978 (P.L. 95-615) carefully measured provisions for Americans working abroad.

BACKGROUND

The long history of the earned income exclusion has been reviewed elsewhere[1] and need not be repeated. Three brief points might be recalled, however. First, the earned income exclusion was originally conceived of as a "foreign trade" exemption. It never rested on a policy of tax equity for Americans abroad. Second, differences in tax treatment according to the taxpayer's geographic location is not a new idea. President Kennedy proposed eliminating the exclusion for taxpayers in developed countries and retaining it for taxpayers in less developed countries. Third, in 1974, when this matter was being considered by the House Ways and Means Committee in the early stages of what was to become the Tax Reform Act of 1976, it was decided to abolish the exclusion. This decision was later modified because of concern about employees of charitable organizations and construction companies.

POLICY

Congress in the recently enacted law reverted to the policy originally adopted, that is, tax benefits for Americans abroad are necessary to promote trade abroad.[2] The actual effect of Americans abroad is difficult to quantify, but there is little doubt that it exists. A recent Treasury Department analysis states that "a one percent decline in Americans abroad is projected to result in slightly over an half percent decline in the value of U.S. exports. Thus, if the number of Americans abroad

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* This comment on the Foreign Earned Income Act of 1978 is based on material which will be published as a copyrighted article in the February 1979 issue of TAXES - The Tax Magazine, Commerce Clearing House, Inc., 4025 W. Peterson Avenue, Chicago, Illinois 60646. The present manuscript is intended to be used solely as conference materials at a workshop on expatriate taxation in London, England on February 8, 1979. All rights are strictly reserved.

** In his capacity as counsel to the Senate Finance Committee, the author played an active role in deliberations over new legislation for overseas Americans, including attendance at the conference committee where final shape was given to the new law.

were to decline by 10 percent, the value of U.S. exports would be projected to decline by 5 percent."[3]

This issue was a bellwether for other issues such as DISC and deferral; and support for it portends support for an effective national export program.

EXPLANATION OF NEW RULES

The Foreign Earned Income Act of 1978 delays until after 1977 the effective date of the changes made by the Tax Reform Act of 1976 to the section 911 exclusion for income earned abroad.[4] Thus, the pre-1976 Act levels of exclusion ($20,000/ $25,000) apply for 1977. For 1978, taxpayers may elect the provisions of the 1976 Act or the provisions summarized below. For 1978 and thereafter, the following provisions will apply. No changes were made in the definition of "earned income". The requirement as to place of receipt (contained in section 911(c)(8), as added by the 1976 Act) was repealed.

Citizens Or Residents Working Abroad

A new deduction (new Section 913) comprised of five elements is allowed U.S. citizens who are bona fide residents of a foreign country for an entire taxable year[5] and U.S. citizens and resident aliens, including those aliens not covered by treaties containing nondiscrimination clauses, who are present in a foreign country for 17 out of 18 months. The total amount of the deduction cannot exceed the total of foreign earned income reduced by the value of employer furnished meals and lodging which is excluded from income and deductions, such as foreign real property taxes, allocable to the foreign earned income. The new deduction is allowable regardless whether the taxpayer itemizes deductions.

COST-OF-LIVING DIFFERENTIAL. The excess cost-of-living in the foreign place where taxpayer's tax home is located over the highest cost-of-living in any metropolitan area in the continental United States (excluding Alaska) is deductible. Tables will be prepared by the IRS annually, will reflect various family compositions, and will assume a family income equal to that of a Step 1, Grade GS-14 U.S. government employee (regardless of the taxpayer's actual income). A Step 1, Grade GS-14 employee is presently paid $32,442 per annum. No computation of this element of the deduction will be required.

For purposes of section 913, foreign place may be limited to a part of a foreign country or may include more than one foreign country. In preparing its tables, the Service may take into account the State Department's Local Index of Living Costs Abroad.

Value added taxes will be reflected in the costs that go into the tables. Tying the deduction to a given family income level limits the benefit available to taxpayers in high cost/ high income areas.

HOUSING EXPENSES. The excess of an individual's "housing expenses" over his "base housing amount" is deductible. "Housing expenses include cost of utilities and insurance but not mortgage interest and taxes otherwise deductible. "Base housing amount" equals 20 percent of the excess of the individual's earned income (from whatever source; reduced by allocable deductions such as trade or business expenses) over the sum of his housing expenses, cost-of-living differential, any school expenses, home leave travel expenses, and any hardship area deduction (in other words, one-sixth of his net earned income).[6] If an individual whose tax home is in a hardship area maintains a second foreign household, described below, the base housing amount for the household maintained at his tax home is zero. Also, except in the case of a qualified second household, housing expenses of only one house can be deducted at a given time, and that house must be the one bearing the closest relationship to the individual's tax home. Of course, an individual can relocate during the taxable year.

This element does require a computation based on the taxpayer's actual expenditures. It will have to be the last element computed.

Questions will arise as to whether certain expenditures fall within the definition of housing expense. Many of these can be answered by the regulations.

SCHOOLING EXPENSES. Where adequate U.S.-type schools are available within reasonable commuting distance of the individual's tax home, schooling expenses consist of the actual costs of tuition, fees, books and local transportation for the elementary or secondary level education of a dependent. If the child is sent to school elsewhere (including in the U.S.), the amount deductible is limited to the amount of tuition, fees, etc. that would have been charged by the U.S.-type school. Where adequate U.S.-type schools are not available, room and board and the cost of transportation between the school and the individual's tax home (without limit) are treated as schooling expenses.

Determining which schools constitute "U.S.-type schools" will not always be easy. Also, where there is a local U.S.-type school but the child attends school elsewhere, determining the tuition, fees, books and local transportation which would have been incurred had the child attended the local school may be difficult.

HOME LEAVE TRAVEL EXPENSES. An individual can deduct the actual cost of an annual roundtrip for himself, his spouse, and each dependent from the location of his foreign tax home to his present or, if none, most recent principal residence in the U.S. (or if he never resided in the U.S., the nearest port of entry in the continental United States, excluding Alaska). Where transportation is by air, the deduction is generally limited to the cost of economy or coach fare. The cost of travel by ship is not subject to this limitation. Also, the deduction is allowed only for one trip per person for each 12 month period for which the taxpayer's tax home is in a foreign country.. It is clear that the trip can be taken during that period; but is not clear whether trips can, in effect, be "stockpiled" for later use.

Except in the case of a qualifying second household, the spouse and dependents must reside with the individual in order to qualify for the schooling and home leave travel expenses deductions.

HARDSHIP AREA DEDUCTION. If an individual's tax home is in a hardship area, he can deduct $5,000 per year, computed on a daily basis. "Hardship area" means, in general, any foreign place designated by the Secretary of State as a hardship post qualifying for a post differential of 15 percent or more of basic salary under the Overseas Differentials and Allowances Act of 1960 (5 U.S.C. 5925). The list of hardship areas is to be up-dated periodically though not necessarily annually.

For example, most locations in the Middle East presently qualify. All locations in India qualify. All locations in the U.S.S.R. qualify.

One problem will be the treatment of taxpayers who live in an area which is designated as "hardship" in, say, December. Should they get the deduction on a daily basis or for the entire year?

Special Rules For Qualified Second Households

Special rules apply to the foregoing elements of the new section 913 deduction if a household is maintained in a foreign country by an individual for his spouse and dependents (if any) at a place other than his tax home because of adverse living conditions at his tax home (that is, conditions which are dangerous, unhealthful, or otherwise adverse).[7] His tax home need not be located in a hardship area. An individual may have only one qualified second household at any time. If an individual maintains a qualified second household, the general rules are modified as follows:[8]

COST-OF-LIVING DIFFERENTIAL. The cost-of-living deduction is based on the foreign place where the qualified second household is located, not on the place of the taxpayer's tax home. The deduction is not disallowed for days during which the taxpayer excludes the value of meals and lodging provided by his employer under section 119. The taxpayer receives no separate cost-of-living deduction for his tax home.

HOUSING EXPENSES. If a taxpayer maintains a qualified second household, he may generally deduct the full cost of housing at his tax home. In addition, he may deduct the excess of the expenses of maintaining the qualified second household over his base housing amount. For purposes of determining the base housing amount for his qualified second household, earned income is reduced by the full housing costs at both the qualified second household and his tax home.

The deduction for excess housing costs at the qualified second household is not disallowed for days during which the taxpayer excludes the value of meals and lodging at his tax home under section 119. Also, the rule which permits the taxpayer to deduct costs only with respect to the household having the closest relationship to his tax home is modified to permit the deduction of excess housing costs at the qualified second household as well.

SCHOOLING EXPENSES. Dependents living at the qualified second household are treated as residing at the tax home so as to permit their schooling expenses to be deducted. The determination of whether the costs of nonlocal travel and room and board are deductible, and of the reasonableness of the expenses, depend on the availability of adequate U.S.-type schools, within reasonable commuting distance of the tax home.

HOME LEAVE TRAVEL EXPENSES. The home leave travel expenses deduction is available for round trips from the qualified second household, rather than from the tax home.

Citizens Or Residents In Certain Camps

Citizens or residents who because of their employment reside in a camp located in a hardship area can either take the section 913 deduction, including the $5,000 hardship area deduction, or elect on a yearly basis, under amended section 911, to exclude $20,000 per year, computed on a daily basis. The residency eligibility is the same for this provision as the section 913 deduction for certain excess foreign living expenses (one year bona fide residence/17 out of 18 months presence). Deductions and foreign tax credits allocable to the excluded amount are lost.

In order to qualify, the camp must constitute substandard lodging which is provided by or on behalf of the employer for the convenience of the employer because the place at which the taxpayer works is in a remote area where satisfactory housing is not available on the open market. The camp must be located, as near as practicable, in the vicinity of the place at which such individual renders services. The lodging must be furnished in a common area (or enclave) which is not available to the public and which normally accommodates 10 or more employees.

It will be noted that this is a fairly tight definition of camp. Many existing facilities may not qualify.

The employee residing in a camp may also exclude the value of employer-furnished meals and lodging - furnished to him, his spouse, or any of his dependents - from gross income under amended section 119. The camp will be considered part of the employer's business premises for purposes of section 119.

Moving Expense Deduction For Foreign Moves

Where the taxpayer moves abroad, the existing moving expense deduction (section 217) is modified as follows: (1) the 30-day limitation on the deduction of the cost of temporary quarters is changed to 90 days, and the dollar limitation on deductibility of those costs and costs of searching for a new residence is increased from $1,500 to $4,500; (2) the overall dollar limitation on the deduction of expenses connected with the sale, purchase and lease of a residence is raised from $3,000 to $6,000 (the limits are $2,250, rather than $4,500, and $3,000, rather than $6,000, in the case of a husband and wife filing separate returns); and (3) deductible moving expenses include the reasonable expenses (without any dollar limitation) of moving household goods and personal effects to and from storage and of storing the goods and effects for part or all of the period during which the taxpayer's new place of work abroad continues to be his principal place of work. Other limitations contained in section 217 continue to apply to foreign as well as domestic moves.

The term "foreign move" means a move in connection with the commencement of work by the taxpayer at a new principal place of work located outside the United States. Thus, a move from the United States to a foreign country, or from one foreign country to another, is a foreign move. A move from a foreign country to the United States is not a foreign move.

A deduction for the costs of moving which are incurred by an individual whose former principal place of work and former residence were outside the United States, and which are incurred for a move to a new residence in the United States in connection with the bona fide retirement of the individual, is allowed without regard to the requirement of section 217 that the individual perform services in the United States as a full-time employee or self-employed person for a specified period of time.

Moving expenses which are paid or incurred by the spouse or any dependent of a decedent who (as of the date of death) had a principal place of work outside the United States are also deductible without regard to the requirement that the taxpayer perform services at the new location. The expenses allowed are those which are incurred for a move which begins within six months after the death of the decedent and which is to a residence in the United States which (as of the date of death) was the residence of the decedent and the individual paying or incurring the expense.

Meals And Lodging Furnished To Employees

One of the requirements contained in section 119 for the exclusion of employer-furnished meals and lodging is that the items be furnished directly by the employer for the convenience of that employer. The Act modifies this requirement so that the exclusion applies with respect to meals or lodging furnished by or on behalf of the employer to the taxpayer, his spouse, or any of his dependents for the convenience of the employer. For example, housing provided by the host country or the prime contractor to an employee of a subcontractor for the convenience of the subcontractor will meet this requirement.

These changes are not limited to meals or lodging provided abroad.

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Suspension Of Period For Nonrecognition of Gain On Sale Of A Principal Residence

Under existing section 1034, if property used by the taxpayer as his principal residence is sold by him and, within a period beginning 18 months before the date of the sale and ending 18 months after that date, property is purchased and used by him as his new principal residence, gain from the sale is recognized only to the extent that the taxpayer's adjusted sales price exceeds his cost of purchasing the new residence. In some cases where a new residence is constructed, the 18 month period is extended to two years. The Act suspends the running of these statutory periods during any time that the taxpayer (or his spouse, if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) has a tax home outside the United States after the date of the sale of the old residence. However, no period of time as so suspended may be extended beyond the date four years after the date of the sale of the old residence.

This suspension rule follows the rule presently available to members of the armed forces.[9]

It should be noted that taxpayers returning to the U.S. after, say, a three and one-half year absence will be left with little time to reinvest in a new home.

Treasury Department Reports And Wage Withholding Rules

As soon as practicable after the close of calendar year 1979 and after the close of each second calendar year thereafter, the Treasury Department is to report on the workings of the exclusions and special deductions available to private and civilian government employees working abroad.

The Act also provides that employers are not required to withhold on remuneration (for example, allowances) paid to employees if offsetting deductions are allowable under new section 913.

Effective Dates

The Act is generally effective for taxable years beginning after December 31, 1977. The wage withholding rules apply to remuneration paid after the date of enactment (November 8, 1978). As previously noted, the pre-1976 Act rules automatically apply to 1977. The new rules will apply to 1978 unless the taxpayer elects otherwise on his return, in which case the 1976 Act rules will obtain. Taxpayers cannot avail themselves of the new moving expense rules, for example, and avoid the new section 913 rules for 1978.[10]

Conclusion

The new provisions will cost an estimated $412 million per year. Complete exemption of income earned by Americans abroad would cost in the neighborhood of $720 million per year. In light of these estimates, some overseas taxpayers undoubtedly will say that it would be better to simply exempt Americans working abroad from tax on their foreign sourced earned income. Others might remark that these provisions are a great improvement over the 1976 Act provisions (which cost approximately $194 million per year), and might look forward to their simplification by a future Congress.[11]

From any perspective, the new legislation should be seen as a reflection of Congress' desire to take a measured step towards tax relief for Americans abroad.

The views expressed are those of the author. They do not necessarily represent the views of any other person or group.

1. For a review of some of the legislative history as well as an interesting discussion of policy, see Patton, United States Individual Income Tax Policy As It Applies To Americans Resident Overseas, 1975 DUKE L.J. 691 (1975). See also, Mark Tobey, 60 T.C. 227.

2. See Taxation of Americans Working Abroad, Hearing before the Committee on Finance, 95th Congress, 2d Sess. (May 8, 1978).

3. Mutti, "The American Presence Abroad and U.S. Exports", OTA Paper 33 (October, 1978).

4. For a description of the 1976 Act changes, see Jt. Comm. on Taxation, General Explanation of the Tax Reform Act of 1976, pp. 212-215 (1976). The rules for associating foreign taxes with the amounts excludable "off the bottom" under section 911 as amended by the 1976 Act are provided by section 701(u)(10) of the Revenue Act of 1978.

5. A recent Technical Advice Memorandum raises the possibility that a resident alien might also meet the test of "bona fide resident of a foreign country." Such an individual, if he could exist, would not be covered under the new provisions. Technical Advice Memorandum to District Director, San Francisco, dated June 20, 1978.

6. Twenty percent of earned income in excess of, among the other items enumerated, all housing expenses equals one-sixth of earned income in excess of, among the other items, excess housing expenses.

According to Bureau of Labor Statistics data, typical U.S. housing costs equal one-sixth of spendable income.

7. The Conference Report states that the "adverse living conditions" requirement should be liberally construed.

8. The following description and portions of the discussion of moving expenses and the section 119 exclusion are drawn from the committee report which accompanied the House version of the legislation. H.R. REP. No. 95-1463, 95th Cong., 2d Sess. 14-15 (1978).

9. Section 1034(h), Internal Revenue Code of 1954.

10. The Act does not specify how the provision suspending the period for reinvestment in a new principal residence affects sales which took place before December 31, 1977.

11. The revenue estimates in the text are based on calendar year 1978 figures.

Tile / Section 911

FOR IMMEDIATE RELEASE JANUARY 24, 1980

Office of the White House Press Secretary

THE WHITE HOUSE

TEXT OF A LETTER FROM THE
PRESIDENT TO THE SPEAKER OF THE
U.S. HOUSE OF REPRESENTATIVES
AND THE CHAIRMAN OF THE SENATE COMMITTEE
ON FOREIGN RELATIONS

Dear Mr. Speaker: (Dear Mr. Chairman:)

Section 611 of Public Law 95-429, as amended by Section 406 of Public Law 96-60, required that I transmit a report to you on Federal statutes and regulations which "treat United States citizens living abroad differently from United States citizens residing within the United States or which may cause, directly or indirectly, competitive disadvantages for Americans working abroad relative to the treatment by other major trading nations of the world of their nationals who are working outside their territory".

On August 27, 1979, I transmitted to you such a report, addressing many of the legal provisions that affect U.S. citizens residing abroad and comparing those provisions with the treatment accorded U.S. citizens residing in the United States. Modest but useful recommendations were made, and this Administration has taken steps to follow up on them, as noted at the end of the report enclosed with this message.

The additional report I am now transmitting concentrates on the taxation of Americans living abroad. It is clear to me that the phrase "competitive disadvantage" refers primarily to Federal taxation. Therefore, as I noted in my message of August 27, 1979, I asked the Secretary of the Treasury to prepare a report on this complicated subject, which, as you know, has involved the Congress and this Administration in long deliberations in recent years.

The various studies undertaken on the taxation of Americans living abroad do not yet provide clear evidence of competitive disadvantage and its impact on American economic interests. In addition, the Foreign Earned Income Act of 1978 has been in place for only one year. Consequently, the Treasury Department has not yet had a chance to submit to Congress, as required by that Act, a report on the operation of the new provisions for tax year 1979 and on the economic and revenue effects of the new law. Until some assessment is made for at least the first year's operations, I believe it prudent not to recommend changes in the law.

I believe, however, that this report will be helpful to the Congress and to the Administration in understanding the complicated and controversial area of tax policy and law. I fully intend to explore these important matters and to work with the Congress in developing any needed improvements.

Sincerely,

JIMMY CARTER

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